



*A companion guide to the
Annual Financial Report FY 95*

Serving the Nation Through Progressive Stewardship

***The American people expect a high
quality Army, and they expect its
leaders to be good stewards of
public resources...***


***The Army has made many notable
improvements, and is now recognized
as a leader in financial management
reform in the Department of Defense.
The bottom line is that Americans can
have confidence in both the U.S. Army
and its financial management.***

**Togo D. West, Jr.
Secretary of the Army
February 1996**

Objective

This document is designed as a **guide** to the Department of the Army FY 1995 Annual Financial Report. It is intended to provide readers with an understanding of key financial information as it relates to decision making within the Army and compliance with related legislative requirements. This guide focuses on financial and program management information from the FY 1995 Annual Financial Report for general funds, which was prepared by the Army and the Defense Finance and Accounting Service - Indianapolis Center (DFAS-IN), as required by the Chief Financial Officers Act of 1990, as amended.

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Serving the Nation Through Progressive Stewardship

Organization of the Guide to the Department of the Army FY 1995 Annual Financial Report

Section I -- America's Army: Meeting the Challenges of Today, Tomorrow, and the 21st Century provides an overview of the operational and resource challenges facing the Army today and into the future.


Section II -- Federal Management Reform describes significant federal financial and program management reform initiatives -- the Chief Financial Officers Act of 1990, the Government Performance and Results Act of 1993, and the Government Management Reform Act of 1994.

Section III -- Army Stewardship provides additional information on the requirements of the Chief Financial Officers Act and highlights the Army's experience as a pilot for agency-wide audited financial statements. This section also describes a number of related initiatives intended to improve Army stewardship and accountability.

Section IV -- Department of the Army FY 1995 Annual Financial Report provides an overview of the entire general fund annual report, with emphasis on key items in the financial statements.

Section V -- Changes in Authoritative Guidance summarizes recent changes and discusses potential implications for future Army financial reporting.

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The Army Vision

The world's best Army -- trained and ready for victory. A Total Force of quality soldiers and civilians

A values-based organization

An integral part of the joint team

Equipped with the most modern weapons and equipment the country can provide

Able to respond to our Nation's needs

Changing to meet the challenges of today... tomorrow... and the 21st century

I. America's Army -- Meeting the Challenges of Today, Tomorrow, and the 21st Century

The United States Army is the world's preeminent land combat force. Although smaller now than at any time since before World War II, it is not just a smaller version of the "Cold War" Army. It is a power projection force, based primarily in the United States, and capable of deploying rapidly to virtually anywhere in the world.

The Army serves the nation proudly, as it has for over 200 years, and fulfills many challenging roles. It helps to deter international conflict by maintaining a forward presence overseas and strengthening military relationships with other nations. The Army serves communities here at home by supporting civil authorities during natural disasters, civil disturbances, and other emergencies.

Today's Army is being called upon for an ever greater number, and greater variety, of missions. Since 1989, operational deployments have increased over 300 percent, and the soldier in an operational unit today spends an average of 165 days a year away from home station and family. Figure I-1 illustrates a typical day for America's Army during Fiscal Year (FY) 1995.

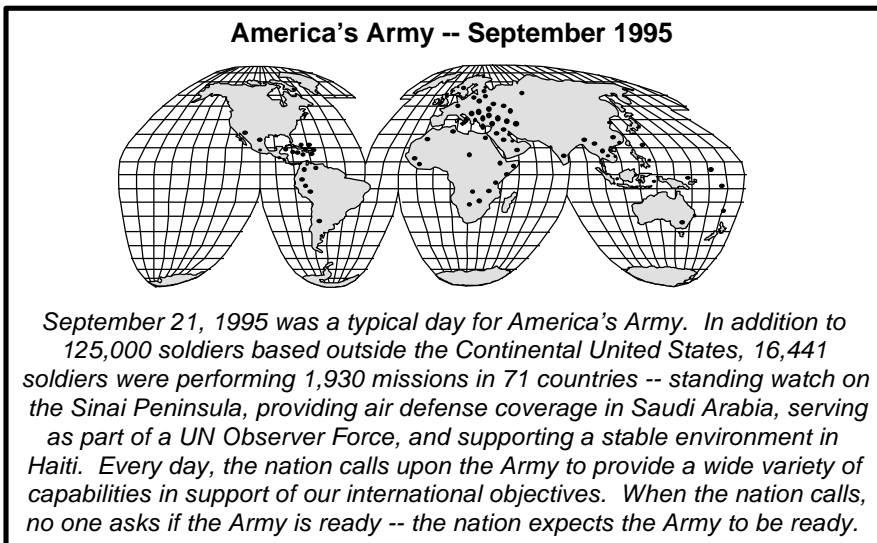


Figure I-1

Resource Challenges

The Army is meeting these operational challenges successfully, even in this era of extraordinary resource challenges. From FY 1989 - 95, the active component of the Army reduced in size from 18 divisions to 12 -- it is now only the eighth largest army in the world. The reserve component reduced from 10 divisions to 8. Personnel reductions total well over half a million. During the same period, over 650 facilities worldwide were reduced or closed.

As America's Army moves towards the 21st century, it confronts three key challenges:

- maintaining readiness,
- gaining stability in personnel, quality of life, installations, and funding, and
- becoming more efficient.

Funding

From FY 1989 - 95, the Army's total budget (obligation) authority declined 31 percent. As illustrated in Figure I-2, the level of funding in the FY 1997 President's Budget submission for the Army equals a reduction of nearly 36 percent from FY 1989.

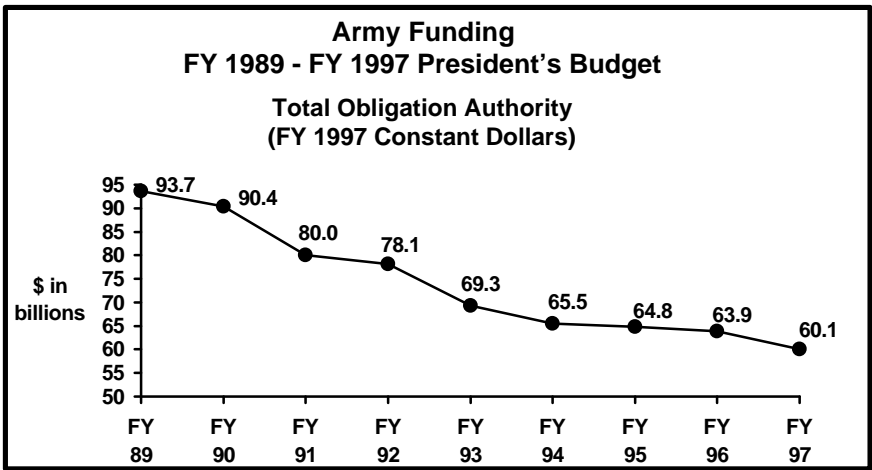


Figure I-2

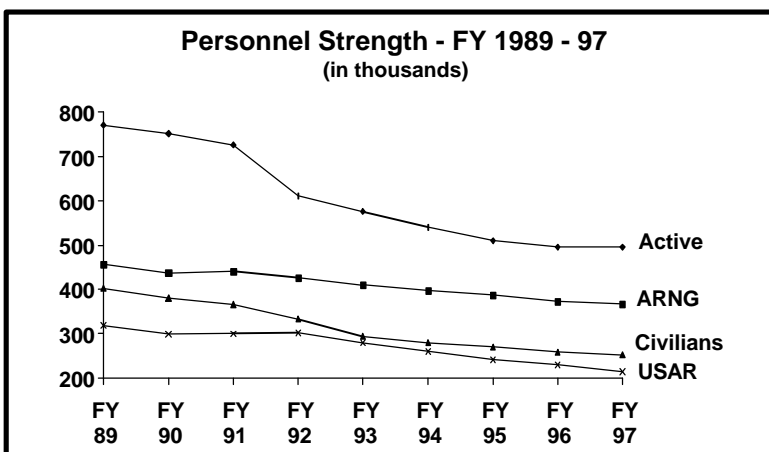
The funding of contingency operations remains a problem. These unprogrammed operations (e.g., Haiti, Southwest Asia, Rwanda, the Former Yugoslavia, etc.) are funded temporarily by "borrowing" from readiness accounts, pending action by Congress on supplemental appropriations or reimbursement from outside sources. In FY 1995, contingency operations cost the Army \$844.5 million. Only \$765 million was offset by supplemental funding -- a shortfall of \$80 million. The funding shortfalls and the delays in supplemental funding seriously impact Army training and readiness.

Personnel

Personnel strength has declined steadily since FY 1989. Through FY 1995, military end strength decreased by over 400,000 -- 262,000 active component and 147,000 reserve component personnel. Civilian employees were reduced by 133,000 over the same period. Projected strength in the FY 1997 President's Budget will bring total personnel reductions to 620,000, as shown in Figure I-3.

The Army's most important resource is its people -- *the Army is people*. Maintaining a quality force is one of the Army's highest priorities and one of its greatest challenges.

Quality people are the defining characteristic of a trained and ready Army. They are the single most important requirement for the Army's success today and into the future.



(USAR - US Army Reserve; ARNG - Army National Guard)

Figure I-3

4 Serving the Nation

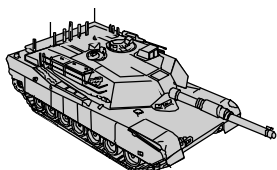
The Army continues to succeed in recruiting and retaining high quality personnel. In FY 1995, the active component achieved its goals for both the quantity and quality of enlisted accessions, and the reserve components (US Army Reserve and Army National Guard) achieved the majority of their goals. Retention of quality soldiers is essential for readiness, and in FY 1995 the active component met 100 percent of its goal for initial term reenlistments and 96 percent of the mid-career reenlistment goal.

The combination of reduced force structure and increased operational commitments has placed an extraordinary burden on soldiers and their families. If the Army is to continue to attract and retain the quality people vital to its success, it must stabilize the force and ease personnel turbulence. No amount of training or technologically superior equipment will suffice if there are not enough quality people to accomplish what the nation demands.

Modernization

Modernization is the continuous process of integrating new doctrine, organization, training, leader development, and materiel to develop and field warfighting capabilities. The goal of the Army modernization strategy is to enhance soldiers' warfighting and survival capabilities by taking advantage of technological advances.

Modernization is essential now; a smaller force requires increased lethality, and obsolete equipment must be replaced. Scarce modernization dollars require the Army to buy only a limited number of new systems, while extending the lives and improving the capabilities of existing systems. The modernization necessary to maintain the technological edge that allows the Army to dominate the battlefield can occur only with additional resources.



***Modernization is
essential for the
Army as it prepares
to enter a new
century.***



Installations

Installations are both home to America's Army and strategic power projection bases. They are undergoing significant changes to meet the challenges of today's Army, and must become bases capable of deploying troops where needed anywhere in the world and sustaining them for as long as they are there. The same installations



must continue to provide an adequate living and working environment for soldiers, their families, and civilian employees.

During 1995, the Army closed the last of 77 installations scheduled for closure by the 1988 Base Realignment and Closure (BRAC) Commission. The past year also saw approval of the final list of installations to be closed or realigned under the BRAC Act of 1990. The Army is continuing to accelerate all BRAC actions in order to obtain savings as quickly as feasible. Four of the five closures approved by the 1991 Commission have occurred already, and the Army began working aggressively in 1995 to initiate the 29 closures and 11 realignments recommended by the 1995 Commission.

The Army is converting installations into power projection bases capable of moving and sustaining a force anywhere in the world. Those same installations must continue to provide an adequate living and working environment...

Becoming More Efficient

The continuing decline in resources is one of the greatest challenges today's Army faces. More than any other factor, resources affect the Army's ability to remain trained and ready and able to respond to security threats anywhere in the world. Resources affect virtually every aspect of Army operations -- the number and quality of people serving, the pace of training, the maintenance of equipment and infrastructure, and the amount of modernization. A quality force costs money, and constrained resources force tough choices.

The Army is working to ensure there will be sufficient resources to maintain a force structure commensurate with operational commitments, invest in essential modernization, and enhance quality of life programs for soldiers and their families. By taking advantage of technological advances, streamlining processes, and reorganizing institutions, the Army can gain significant savings and improve its effectiveness and efficiency.

The Army is emphasizing stewardship at every level and is aggressively seeking to get the most out of scarce resources by fundamentally changing our operating practices. All reasonable avenues to avoid costs and generate savings are being explored. These include reviewing business practices, revising policies, and proposing organizational changes.

From the United States Army Posture Statement, FY 1997

The Army is emphasizing improved resource management at every level, and is committed to demonstrating its responsible stewardship of the nation's resources and the taxpayers' investment.

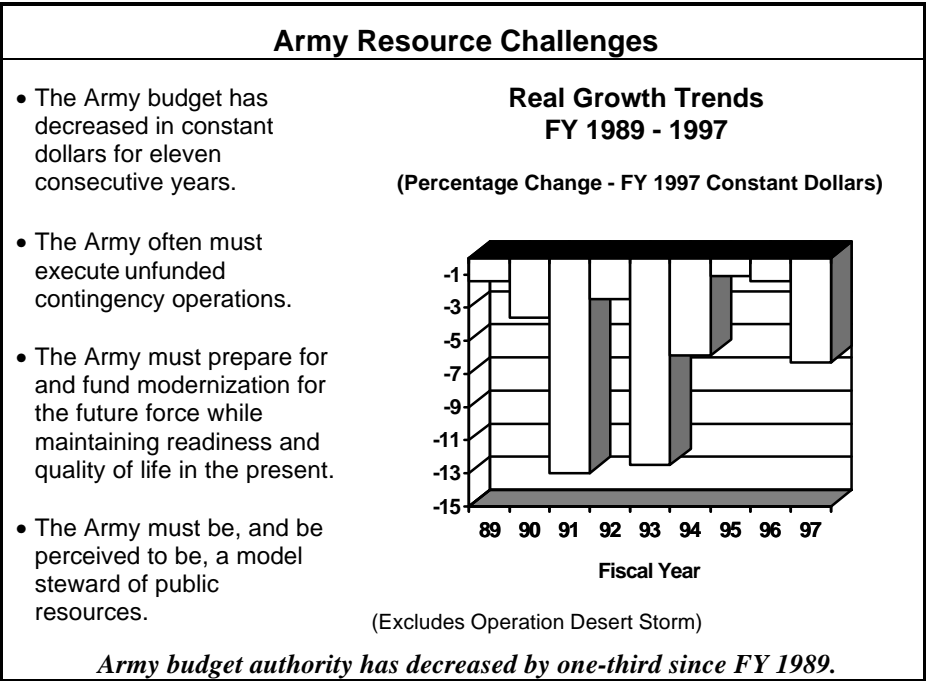


Figure I-4

II. Federal Management Reform

The operational and resource demands facing today's Army become even more challenging when addressed in the overall context of current government reform efforts. Among the most significant of these are new laws intended to make the government more efficient, more effective, and more accountable to taxpayers -- the Chief Financial Officers Act, the Government Performance and Results Act, and the Government Management Reform Act. Taken together, the provisions of these important new laws form the framework for greatly improved federal financial and program management.

***Vastly improved financial management is critical
to the overall effort to reform government.***

Vice President Al Gore
The National Performance Review

The Chief Financial Officers Act of 1990

The Chief Financial Officers (CFO) Act, P.L. 101-576, established the Deputy Director for Management and the Office of Federal Financial Management within the Office of Management and Budget (OMB); created CFO positions in major federal agencies, and established the CFO Council to coordinate agencies' financial management activities. CFO responsibilities include developing and maintaining integrated accounting and financial systems; providing for complete, reliable, consistent and timely financial information; and systematic performance measurement. OMB is required to report to Congress annually on the status of federal financial management and plans for improvement.

Among its most significant provisions, the CFO Act requires federal agencies to submit annual audited financial statements for revolving funds, trust funds, and substantially commercial functions. These are corporate-style annual financial reports that are based on proprietary, not appropriation, accounting, and include an independent audit opinion. In addition, the law designated ten agencies as pilot projects for audited financial statements covering *all agency operations*. The Army was designated a pilot for FY 1991 and 1992; OMB later extended the pilot project through FY 1995.

The Government Performance and Results Act of 1993

The Government Performance and Results Act (GPRA), P.L. 103-62, is intended to increase public confidence, and improve program effectiveness and public accountability, by holding agencies accountable for results. The law builds on the CFO Act requirement for “systematic measurement of performance,” and will become the basis for linking resources to results throughout the government. In addition, OMB intends to use the GPRA as the framework for its annual financial management status report and improvement plan.

Under the GPRA, agencies are required to submit five-year strategic plans, beginning September 1997, that include comprehensive mission statements and general goals and objectives. Beginning with the FY 1999 budget, agencies must submit annual performance plans that include objective, measurable performance goals and required resources for every major activity in the agency budget. Beginning March 2000, agencies must submit annual reports of actual performance against the previous year’s plans.

The Government Management Reform Act of 1994

The Government Management Reform Act (GMRA), P.L. 103-356, was drawn from provisions of the omnibus reform bill based on the recommendations of the National Performance Review. Title IV, which is also cited as the “Federal Financial Management Act of 1994,” requires agency-wide audited financial statements for all agencies covered by the CFO Act, effective FY 1996. The law also requires a consolidated government-wide audited financial report, effective FY 1997.

The GMRA authorizes OMB (on a test basis) to adjust the frequency, due dates, and reporting requirements of any statutorily-required reports under laws for which OMB has financial management responsibility. In its accompanying report, the Senate Committee on Governmental Affairs encouraged the Director of OMB to consider consolidating or adjusting the financial reporting requirements of a number of laws. The Army has long been an advocate of such consolidation, not just to reduce reporting requirements, but to integrate and improve the presentation of a variety of information relating to resource stewardship and accountability.

Federal Management Reform Legislation
<p style="text-align: center;"><u>Chief Financial Officers Act of 1990</u></p> <p>Purpose: To improve management practices in the federal government and systems of accounting, financial management, and internal controls.</p> <p>Major Provisions:</p> <ul style="list-style-type: none"> • Established OMB Deputy Director for Management and Office of Federal Financial Management. • Requires federal financial management status report and five-year plan. • Established CFOs in major federal agencies and the CFO Council. • Requires annual agency audited financial statements for revolving, trust, and substantially commercial funds; directed ten pilots for agency-wide reports. <p>Army Implementation Status: As a CFO pilot, the Army developed agency-wide audited financial statements for Fiscal Years 1991-1995.</p>
<p style="text-align: center;"><u>Government Performance and Results Act of 1993</u></p> <p>Purpose: To improve public confidence, federal program effectiveness, and public accountability; to improve congressional decision making by providing more objective information on the effectiveness and efficiency of federal programs.</p> <p>Major Provisions:</p> <ul style="list-style-type: none"> • Requires agency strategic plans and annual performance plans, effective 1997. • Requires annual agency reports of actual performance against planned goals. • Directed pilot projects for performance measurement, managerial flexibility, and performance budgeting. <p>Army Implementation Status: Three Army organizations are performance measurement pilots.</p>
<p style="text-align: center;"><u>Government Management Reform Act of 1994</u></p> <p>Major Provisions:</p> <ul style="list-style-type: none"> • Requires agency-wide audited financial statements for all agencies covered by the CFO Act, effective FY 1996; requires a consolidated, government-wide report, beginning FY 1997. • Authorizes the Director of OMB (on a test basis) to adjust the requirements of, or consolidate, any statutorily required reports under laws for which OMB has financial management responsibility. <p>Army Implementation Status: The Army is widely recognized as a leader in CFO Act implementation, and has set the standard for DoD. Army is working with the Office of the Secretary of Defense, the Defense Finance and Accounting Service, and other DoD agencies to implement DoD-wide CFO reporting.</p>

Figure II-1

Financial Reporting Under the CFO Act and GMRA

The annual financial statements required by the Chief Financial Officers Act, as amended by the Government Management Reform Act, differ greatly from traditional federal financial reporting. The following narrative provides background information on financial statements, discusses key differences between the financial statement process and the budget process, and describes the importance of the associated financial statement audits.

Annual Financial Statements

Financial statements provide a historical look at an entity's financial position and the results of its operations. Over time, they are intended to provide stakeholders, including the taxpaying American public, with the same assurance of fiscal accountability that stockholders receive, by law, from publicly held corporations. The statements are not an end in themselves; much of the benefit comes from coordinating the people, systems, functional processes, and financial information to prepare them.

Financial statements are prepared based on a hierarchy of standards. At the top of the hierarchy are the individual accounting standards proposed by the Federal Accounting Standards Advisory Board (FASAB) and published by the Joint Financial Management Improvement Program (JFMIP) principals -- the Office of Management and Budget (OMB), the General Accounting Office (GAO), and the Department of the Treasury. The second level of the hierarchy is guidance issued by OMB on the form and content of financial statements. To the extent that authoritative guidance is not available from FASAB and OMB, agencies are allowed to follow internal accounting policies and procedures, provided they are "prevalent practices" in the federal government. In the absence of any specific policy or guidance, agencies may follow accounting standards published by other authoritative bodies, e.g., Policy and Procedures Manual for Guidance of Federal Agencies - Title 2, Accounting, and generally accepted accounting principles (GAAP). This hierarchy is represented in Figure II-2.

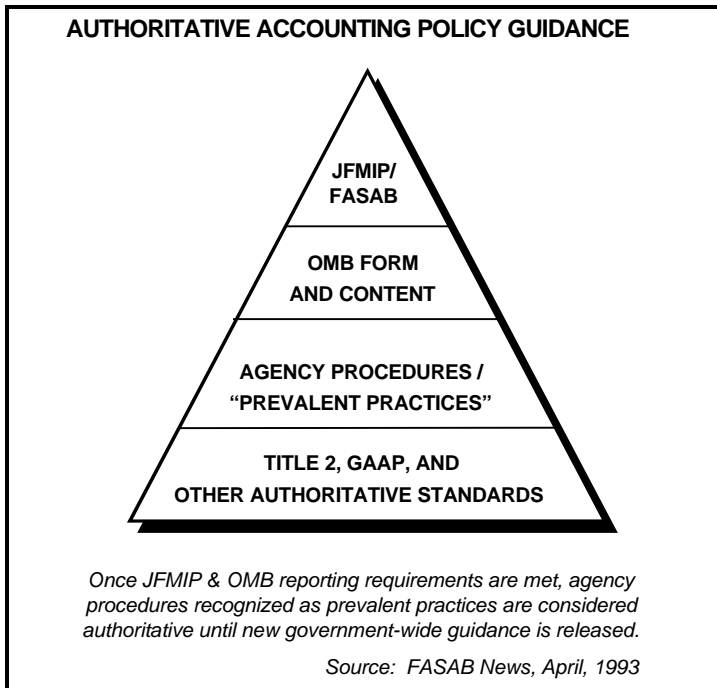


Figure II-2

Financial Statement Audits

The requirement for annual financial statements includes the requirement for an independent audit of each report. Audits are conducted in accordance with prescribed procedures. The scope of the audit encompasses the financial statements and related internal controls and compliance with applicable laws and regulations. The audits force additional discipline on the process because the auditors address the same areas each year and report on progress made in correcting previously identified findings.

The Relationship Between Financial Statements and Budget

The budget formulation and execution process has been the traditional vehicle for managing federal resources. The requirement to produce proprietary financial statements began only six years ago, when the CFO Act was signed into law. Today, there are few direct relationships between federal budgets and financial statements.

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One of the greatest challenges facing federal managers is to enhance the utility of both documents by relating them as appropriate. Key characteristics of federal budgets and financial statements -- their purpose, timing, measurement, and content -- are highlighted in Figure II-3.

The differences between the financial statement preparation process and the budget formulation and execution process exemplify the difficulties the Army and other agencies have in developing auditable financial statements. Many of the existing appropriation-based and functional systems are designed to accommodate the budget process, but not the financial statement process.

Characteristics of the Budget vs. Financial Statements		
	Budget	Financial Statements
Purpose	Translates policy objectives into resource spending levels.	An actual accounting of how resources were utilized.
Timing	Completed in February/March preceding the start of the budget year. For example, the Executive Branch budget process for FY 1997 was released in March 1996.	Issued after the budget process for the next fiscal year is largely completed. For example, the financial statements for FY 1995 were due on March 1, 1996. Thus, the financial statements are not available for developing the FY 1997 budget.
Measurement	Cash basis measurement. Obligations (encumbrances) are generally recorded, with certain exceptions, when orders are placed and goods or services are requested. Outlays are recorded when obligations are paid. Receipts generally are recorded when checks are received.	Accrual basis measurement. Expenses are recorded when the government incurs a liability to pay for goods and services, and revenues are recorded when they are earned.
Content	Appropriation accounts are the budget vehicle for most federal agencies; they are generally organized by function.	Financial statements are organized by reporting entity. A reporting entity includes all the revenues and costs associated with an entity's activity, including budgetary appropriations and related salaries and other cross-functional overhead expenses.

Figure II-3

III. Army Stewardship

From the beginning, senior Army leadership has been committed to both the letter and the spirit of the CFO Act, and has demonstrated a positive and energetic approach to its implementation. The findings and recommendations from the CFO audits have helped the Army to frame a comprehensive stewardship improvement effort that benefits all aspects of Army management and mission accomplishment.

The Army CFO Act Pilot

The Chief Financial Officers Act designated the Department of the Army as a pilot for agency-wide audited financial statements for FY 1991 and 1992. In June 1992, the Office of Management and Budget (OMB) extended the pilot project through FY 1995.

I feel strongly that the Chief Financial Officers Act and its accompanying financial management standards will provide long-range benefits to the Army... I believe these benefits will greatly improve the Army's financial management.

**Michael P. W. Stone
Secretary of the Army
Before the Senate Committee
on Governmental Affairs
August 7, 1992**

Through five consecutive years of financial statements, the Army's auditors -- the General Accounting Office (GAO) for FY 1991 and 1992, and the US Army Audit Agency from FY 1993 through 1995 -- have been unable to express an opinion on the reliability of those statements. The overarching problem preventing the auditors from issuing an audit opinion is that the accounting systems which support the statements do not meet requirements for generating reliable, auditable financial information. The Army has been working with the Under Secretary of Defense (Comptroller), the Defense Finance and Accounting Service (DFAS), and the other military departments to bring about the necessary and comprehensive reforms of DoD financial management systems and related processes. A great deal of progress has been made, but it will take years to achieve streamlined and reliable financial systems.

Although the accounting systems are the single greatest factor cited in the audit reports, other audit findings have highlighted stewardship and financial management problems within the Army's ability to resolve. In response, the Army has been, and continues to be, involved in a variety of disciplined efforts to improve internal management practices, ensure fiscal responsibility, and promote sound stewardship.

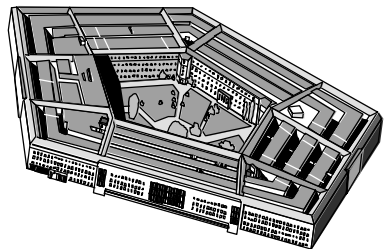
Management Controls

One of the most immediate outcomes of the earliest audits under the CFO Act was the restructuring of the Army management control process. Although the Army had a good management control policy and framework, the auditors found that commanders and managers in the field simply were not using it.

The new process, which took effect in October 1994, reduces workload and promotes ownership and accountability by limiting required evaluations to key management controls, by giving commanders and managers greater flexibility in conducting evaluations, and by raising the level of responsibility for certifying evaluations. The Army's revised approach to management controls and compliance with statutory requirements is the strongest in the Department of Defense -- and it is based on the fundamental premise that management controls are an inherent responsibility of commanders and senior managers.

The Act is a critical element in the Army's efforts to improve stewardship of scarce resources. We are enthusiastically working to implement the CFO Act, not only because it's the law, but also for the simple reason that every single dollar is important in today's Army.

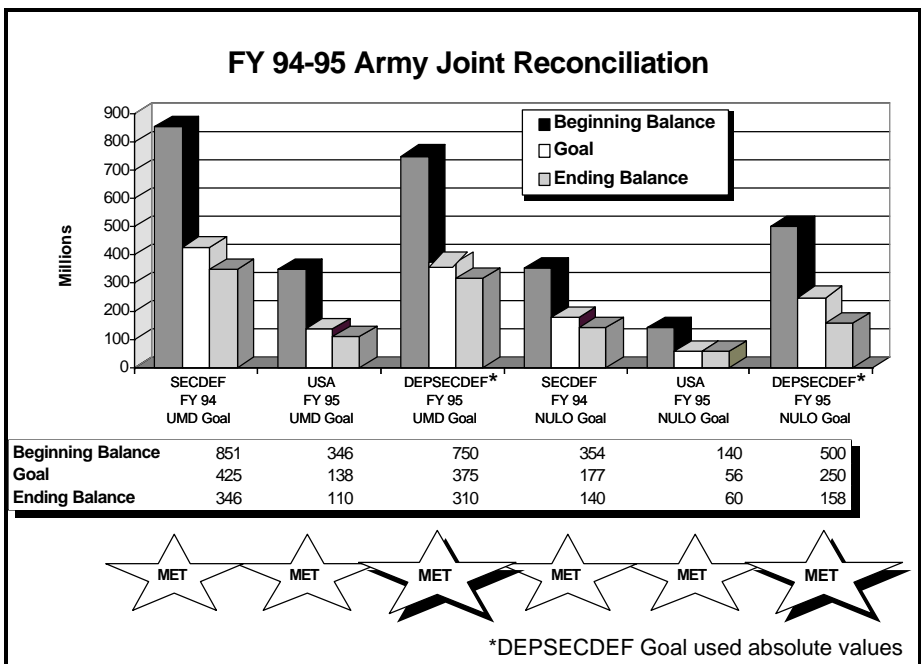
**Helen T. McCoy
Assistant Secretary of the Army
(Financial Management and Comptroller)
Before the Senate Committee
on Governmental Affairs
July 12, 1994**



Joint Reconciliation

The Army Joint Reconciliation Program is another success story. It combines the financial skills of accounting and budget personnel with the expertise of acquisition specialists, logisticians, auditors, and legal staff in teams to analyze "problem disbursements" -- payments that do not match the obligations on the books. The elimination of problem disbursements is one of the highest priorities within DoD because if they are not resolved in a timely manner, current year dollars must be diverted to pay outstanding bills from previous years.

During FY 1995, through a concerted joint Army and DFAS effort, Army exceeded all DoD goals for reducing problem disbursements. Army reduced unmatched disbursements by 51 percent, negative unliquidated obligations by 70 percent, and contingent liabilities associated with canceling year appropriations by 96 percent. Figure III-1 illustrates Army accomplishments for FY 1994 and 1995. (Values are as of 30 June each year, the target date for the goals.)



SECDEF - Secretary of Defense
 USA - Under Secretary of the Army
 DEPSECDEF - Deputy Secretary of Defense

Figure III-1

Functional and Financial Partnerships

The Army financial management community has formed strong and lasting partnerships with functional proponents in the Army and throughout DoD. Key efforts focus not only on improving systems interface capabilities, but on a variety of business process reengineering initiatives. Significant ongoing Army efforts include:

- Logistics and financial management personnel are conducting a review of the processes to requisition and account for supplies that will lead to the interface of the logistics supply system with the accounting system.
- The personnel and financial management communities are working to integrate military pay and personnel systems. In the interim, systems changes to place a total of 93 pay-related events into the personnel system will be completed by January 1997.
- Financial management and Army general counsel personnel jointly streamlined the administrative and legal review process for open Anti-Deficiency Act cases. During FY 1995, this resulted in an 85 percent reduction in open cases, from 33 to five.

As a direct result of our experiences as a CFO Act pilot, we have recognized that sound financial management and stewardship transcend any individual organization, functional area, or system. Within the Army, we are breaking down the traditional stovepipe barriers between functional and financial managers, and working together to fix our problems and improve every aspect of our stewardship.

Helen T. McCoy
Assistant Secretary of the Army
(Financial Management and Comptroller)
Before the House Subcommittee on Government Management,
Information and Technology, November 14, 1995

Initiatives such as these exemplify the Army's commitment to making "CFO" its way of doing business. The impact of Army efforts has expanded beyond internal federal financial management forums. In testimony before the Senate Subcommittee on Defense, Committee on Appropriations, in May 1995, the Comptroller General praised Army's implementation as one of two encouraging CFO Act developments within the Department of Defense.

... Army's proactive approach to implementing the CFO Act has been noteworthy... its top leadership made strong, visible commitments to addressing the Act's objectives. This momentum continues today. The Army's advice is now sought by other DoD components seeking to upgrade their financial reporting capabilities.

Charles A. Bowsher
The Comptroller General
May 23, 1995



Other Financial Management Initiatives

The Overview section of the Army's FY 1995 Annual Financial Report discusses the status of a number of additional initiatives that are helping to improve Army financial management and stewardship.

Cash Management

The Army and the DFAS Indianapolis Center have been working together for some time to improve cash management practices. One of the most visible areas of cash management is payments to vendors under the Prompt Payment Act (PPA), which requires making payments to vendors on time to avoid late payment interest charges. Sound cash management involves both minimizing interest charges and taking full advantage of discounts.

PPA interest penalty and lost discount program performance measures are illustrated in Figure III-2. The Army exceeded its goal for PPA interest penalties by incurring interest penalties on only .01 percent of the total amount of disbursements subject to PPA. The lost discount goal of losing no more than 2.0 percent of the total amount of discounts offered subject to PPA was not achieved.

Debt Management

The Army's public debt has grown dramatically in recent years, as a result of demobilization and the rapid reduction in the armed forces, but decreased in FY 1995.

Debt management issues are summarized in Figure III-3.

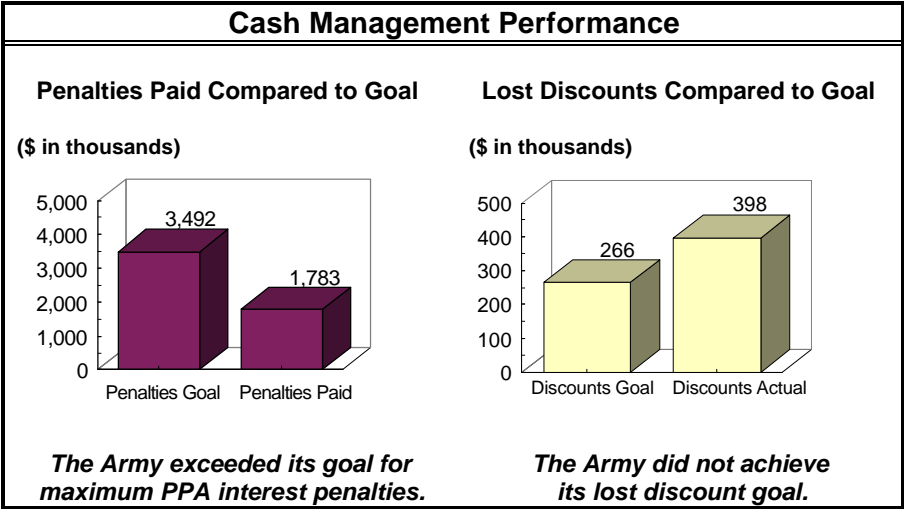


Figure III-2

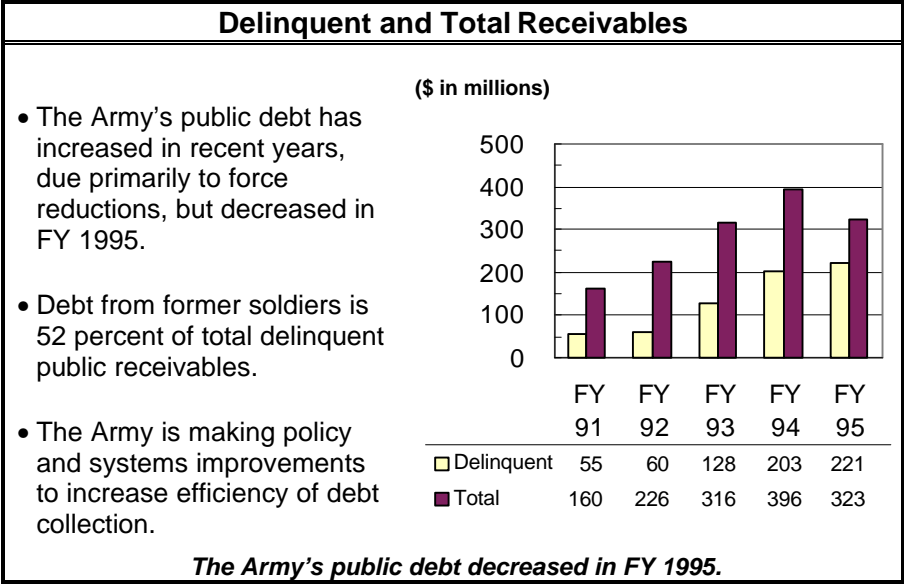


Figure III-3

Improving debt management is important to managers because resources spent on collecting delinquent receivables and on write-offs could be used for other purposes.

IV. Department of the Army FY 1995 Annual Financial Report

The Army and the Defense Finance and Accounting Service Indianapolis Center (DFAS-IN) prepare the Army financial statements using consolidated data from various functional and financial activities. DFAS-IN reconciles the Army's general ledger, status, and expenditure data. The general ledger becomes the basis for preparing the financial statements.

The key participants in the overall annual financial report preparation process are the Office of the Secretary of the Army (OSA), the Office of the Secretary of Defense (OSD), DFAS, the Office of the Chief of Staff of the Army (OCSA), the Major Army Commands, and the Army Staff Principal Advisors, as shown in Figure IV-1.

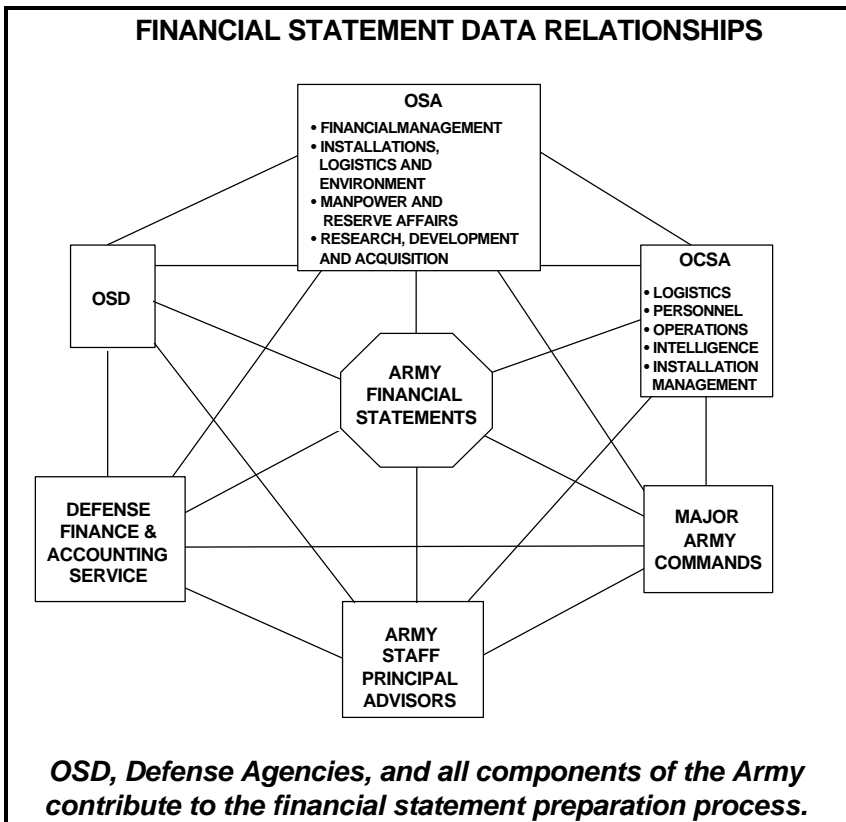


Figure IV-1

Contents of the Annual Financial Report

The Army’s FY 1995 Annual Financial Report consists of four main sections based on the OMB and DoD requirements and guidelines on form and content of financial statements. These four sections are summarized in Figure IV-2 and highlighted in this discussion.

Department of the Army Annual Financial Report
Section 1 - Overview. Overview of Army missions, performance, and financial management issues.
Section 2 - Principal Statements. Financial Statements and Notes that present the Army’s financial status at the end of the fiscal year.
Section 3 - Supplemental Financial and Management Information. Supplemental financial and management information or additional program and performance information not included elsewhere in the report.
Section 4 - Audit Opinion

Figure IV-2

Overview

The Overview describes the Army’s missions, functional activities, significant accomplishments, performance information, and financial management issues. Contents of the FY 1995 Overview are summarized in Figure IV-3.

Contents of the Overview
America’s Army provides highlights of Army accomplishments and discusses how Army missions have changed and expanded in recent years. It includes FY 1995 significant events, and notes the hard choices and resource challenges facing the Army.
Army Missions and Performance describes major functions that support the Army’s principal mission of total force readiness - force structure, manning, modernization, training, mobilization and deployment, and sustaining the force. Goals, objectives, performance measures, and FY 1995 results are included.
Financial Management Issues discusses financial management challenges facing the Army, including accounting systems, cash and debt management, problem disbursements, and budget execution issues.

Figure IV-3

Principal Statements

The Financial Statements and Notes are the end product of Army and DFAS-IN data compilation efforts. Under current OMB guidance, federal agencies are required to produce financial statements, supported by explanatory notes. These statements are similar in nature to reports produced in the private sector. Figure IV-4 provides a synopsis of each statement and shows the relationship to equivalent private sector statements.

Federal Financial Statement	Purpose	Private Sector Counterpart
Statement of Financial Position	Presents the assets, liabilities, and net position of an organization on the last day of the reporting year.	Balance Sheet
Statement of Operations and Changes in Net Position	Summarizes the sources of the organization's financial resources and how they were utilized for the reporting year.	Income Statement

Figure IV-4

The Notes to the Financial Statements (Notes) are an integral part of the Financial Statements. They contain additional information necessary to make the statements more informative. They contain explanations of accounting principles, and provide additional quantitative and qualitative data.

Many activities performed by the federal government are different from those performed in the private sector. As a result, the terminology used in the financial statements to report those activities may differ from private sector terminology. Figure IV-5 provides some examples of line items that are unique to the federal government or that require further explanation.

Federal Financial Statement Line Item	Explanation
Fund Balance with Treasury	The aggregate amount of the entity's accounts with Treasury for which the entity is authorized to make expenditures
Unexpended Appropriations	The amount of the entity's appropriations represented by undelivered orders and unobligated balances
Invested Capital	The net investment of the government in the entity
Program or Operation Expenses	Expenses incurred in conducting the normal activities of the department/agency
Cost of Goods or Services Sold	Costs incurred to produce products sold or provide services to the public and other federal entities. Over 80 percent of the Army's sales and related costs were intragovernmental

Figure IV-5

The following sections present key information from each statement.

Statement of Financial Position

A summarized Statement of Financial Position for FY 1995 as compared to FY 1994 is provided in Figure IV-6.

Comparative Statements of Financial Position (\$ in millions)		
Assets	<u>FY 1995</u>	<u>FY 1994</u>
Fund Balance with Treasury	\$30,017	\$30,863
Accounts Receivable	1,166	1,095
Inventory	1,896	2,010
Property, Plant and Equipment	155,943	160,373
Stockpile Materials	31,265	30,461
Other Assets	<u>1,433</u>	<u>8,897</u>
Total Assets	<u>\$221,719</u>	<u>\$233,698</u>
Liabilities		
Accounts Payable	\$2,730	\$2,735
Accrued Payroll	1,626	1,427
Other Liabilities	<u>3,523</u>	<u>3,728</u>
Total Liabilities	<u>\$7,879</u>	<u>\$7,890</u>
Net Position		
Unexpended Appropriations	\$27,966	\$28,855
Invested Capital	190,559	197,562
Cumulative Results of Operations	(2,422)	1,147
Other	0	405
Future Funding Requirements	<u>(2,263)</u>	<u>(2,160)</u>
Total Net Position	<u>\$213,841</u>	<u>\$225,809</u>
Total Liabilities and Net Position	<u>\$221,719</u>	<u>\$233,698</u>

Note: May not add due to rounding.

Figure IV-6

Assets

A breakout of total assets as shown in the statement and related Notes is shown in Figure IV-7. As illustrated, military equipment represents almost one-half of the Army's assets. Total property, plant and equipment equals over 70 percent of the Army's assets.

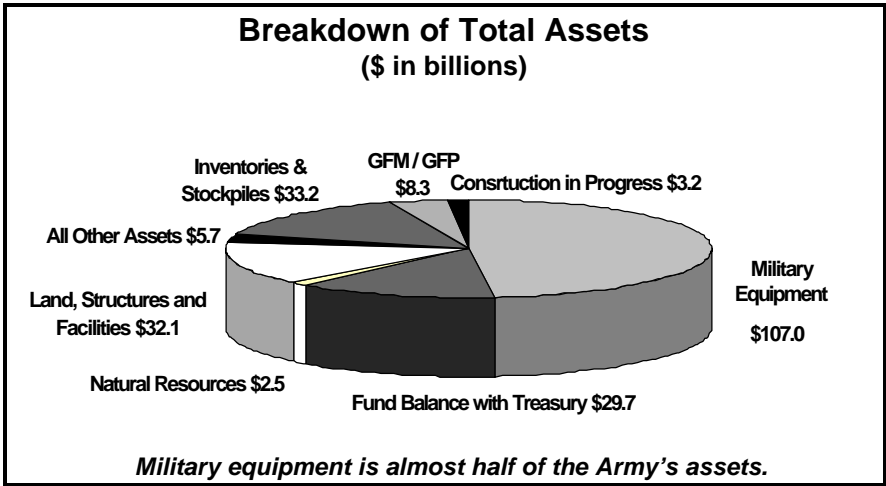


Figure IV-7

Liabilities

Accounts payable are generally recognized upon receipt of goods and services, regardless of whether they are covered by available budgetary resources. The amounts are further broken into federal and non-federal categories in the statement of financial position.

Accrued payroll represents civilian and military payroll and benefits earned but not paid as of the end of the accounting period. The amount is accrued in the statement of financial position as a non-federal liability. FY 1995 accrued payroll and benefits for civilian and military members were \$644 million and \$982 million, respectively.

Other liabilities include \$1,613 million of liabilities that will be liquidated with appropriations that have been received (covered by budgetary resources) and \$1,910 million that will have to be funded with future appropriations (not covered by budgetary resources).

Net Position

The Future Funding Requirements of \$2.3 billion represent accrued liabilities, such as civilian and military annual leave earned but not taken, that are not funded when accrued. Instead, these liabilities are funded and expensed in the period the payments are made. Almost 90 percent of this liability consists of annual leave.

Statement of Operations and Changes in Net Position

A summarized Statement of Operations and Changes in Net Position for FY 1995 is presented and compared to FY 1994 in Figure IV-8.

Comparative Statements of Operations and Changes in Net Position (\$ in millions)		
Revenues and Financing Sources	<u>FY 1995</u>	<u>FY 1994</u>
Appropriated Capital Used	\$53,273	\$55,610
Other Revenues and Financing Sources	<u>6,553</u>	<u>6,796</u>
Total Revenues and Financing	<u>\$59,826</u>	<u>\$62,407</u>
Expenses		
Program or Operation Expenses	\$54,476	\$56,136
Cost of Goods Sold	5,962	6,289
Bad Debts and Write-Offs	37	55
Other Expenses	<u>359</u>	<u>309</u>
Total Expenses	<u>\$60,834</u>	<u>\$62,788</u>
Excess (shortage) of Revenues and Financing Sources over Total Expenses	<u>(\$1,008)</u>	<u>(\$382)</u>

Figure IV-8

The Army's revenues and expenses are nearly equal. The Army, like most federal agencies, relies on appropriations to fund its current activities, and no significant difference between revenues and expenses is expected.

Program or Operating Expenses are 90 percent of total expenses. These expenses decreased 3.0 percent during FY 1995, continuing a downward trend. Personnel Services and Benefits constitute 59 percent of Program expenses, thus making people the Army's largest investment. The major categories of expenditures are shown in Figure IV-9. Figure IV-10 illustrates the downward trend in program expenses.

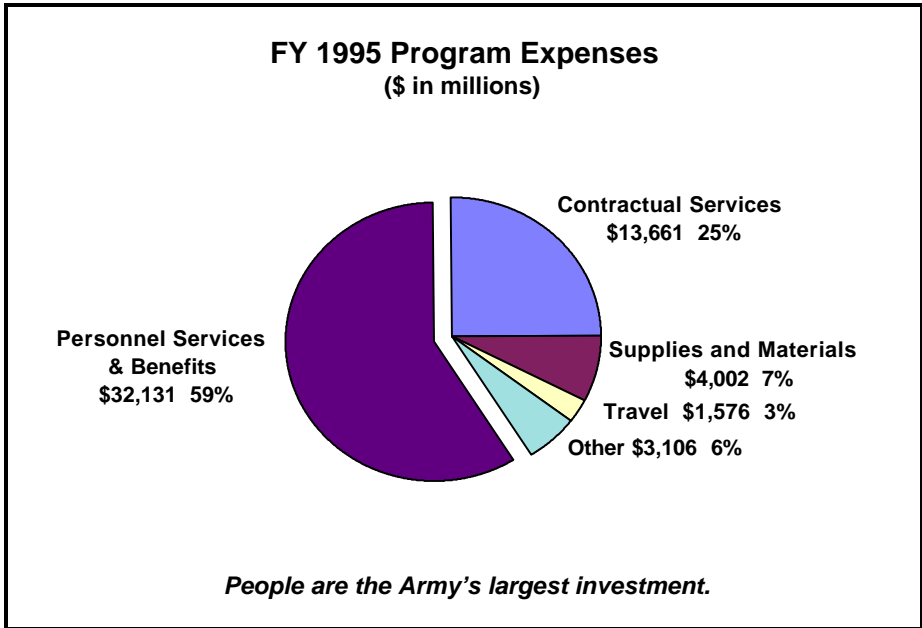


Figure IV-9

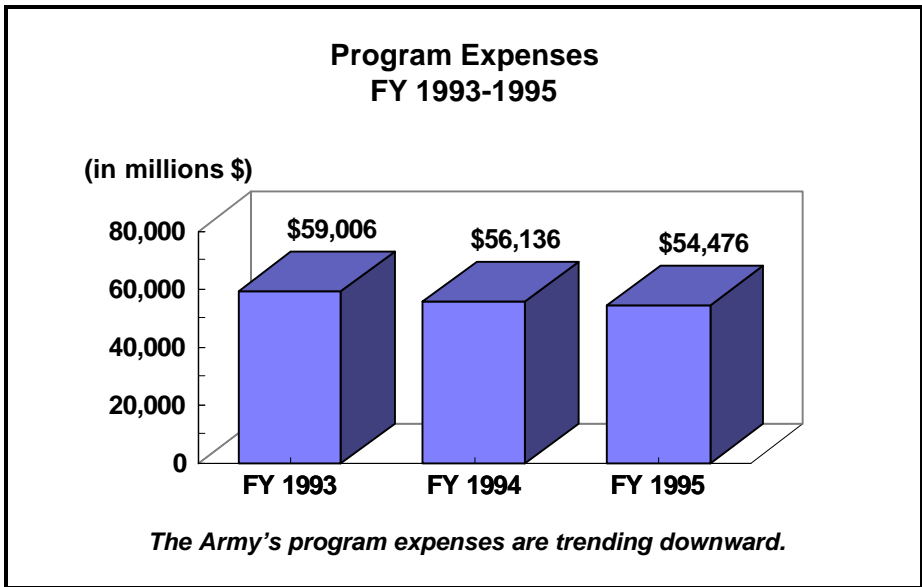


Figure IV-10

Notes to the Financial Statements

The Notes contain a significant amount of quantitative and qualitative information that relates to the absolute amounts in the financial statements. Some of the information from the Notes has been used in the preceding discussions of the financial statements. Additional information is highlighted below.

Note 30, Contingencies

Information in this Note describes potential liabilities that may require additional funding to liquidate. Because these potential liabilities are not a certainty, or cannot be estimated reliably, they are not reflected as "true" liabilities in the financial statements. In accordance with DoD policy, the Army identifies these potential liabilities in the Notes. Figure IV-11 summarizes the areas where the Army has determined significant contingent liabilities may exist.

FY 1995 Contingent Liabilities (\$ in millions)	
Environmental Compliance	\$10,513
Rightsizing	1,522
Workman's Compensation	1,353
Base Realignment	478
Radioactive Waste	417
Re-enlistment Bonuses	300

Figure IV-11

Audit Reports

Under Government Auditing Standards, independent auditors are required to report on (1) the financial statements, (2) internal controls, and (3) compliance with applicable laws and regulations. The annual audits are valuable because they include a comprehensive evaluation of the effectiveness of the Army's financial systems and internal controls leading to the auditor's report on internal controls. The internal control report sets forth reportable conditions and material weaknesses and includes the Army's progress in addressing those matters.

FY 1995 is the fifth consecutive year the Army has undergone a financial statement audit. The Army's auditors (the General Accounting Office for FY 1991 and 1992; the US Army Audit Agency (AAA) since FY 1993) were unable to express an opinion on the financial statements taken as a whole, primarily because the accounting systems that support the financial statements do not have an integrated general ledger or produce comprehensive subsidiary ledgers.

The problem areas cited by the auditors are similar to those found in many federal agencies. Accounting systems deficiencies are the most common issues reported by auditors of federal financial statements. Figure IV-12 highlights key AAA findings for FY 1995.

Status of Audit Findings Identified in the FY 1995 Audit Report
<p style="text-align: center;"><u>Areas of Progress</u></p> <ul style="list-style-type: none">• DFAS-IN improved procedures and controls to prepare statements.• The Army resolved military pay control weaknesses.• DFAS improved the reliability of data on the financial statements by performing comparative analyses for all property account balances and Army National Guard accrued annual leave balances.• Management controls were sufficient to ensure accurate reporting of wholesale munitions.• The Army has achieved significant progress in reducing unmatched disbursements, negative unliquidated obligations, and outstanding travel advances.
<p style="text-align: center;"><u>Areas for Improvement</u></p> <ul style="list-style-type: none">• Dollar values reported for government-furnished property were still unauditable.• DoD policies concerning contingent liabilities and other disclosures continue to prevent the Army from accurately reporting its liabilities.• Estimated costs to repair unserviceable equipment have not been reduced from the value of the equipment.• Army accounting systems did not accurately capture the values of equipment and real property owned by field units and installations or wholesale assets.

Figure IV-12

V. Changes in Authoritative Guidance

The Federal Accounting Standards Advisory Board (FASAB) recommends accounting principles and standards for the federal government. The sponsors of the FASAB -- the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General -- decide whether to adopt FASAB recommendations.

To date, the FASAB has recommended and the sponsors have approved two concept statements and six standards statements. Two additional standards statements are in final review. Collectively, these statements, summarized in Figure V-1, will lead to significant changes in the Army's financial reporting requirements.

FASAB Authoritative Pronouncements
<p>Concepts (Approved Statements)</p> <p>#1 - Objectives of Federal Financial Reporting #2 - Entity and Display</p> <p>Standards (Approved Statements)</p> <p>#1 - Accounting for Selected Assets and Liabilities #2 - Accounting for Direct Loans and Loan Guarantees #3 - Accounting for Inventory and Related Property #4 - Managerial Cost Accounting Concepts and Standards #5 - Accounting for Liabilities of the Federal Government #6 - Accounting for Property, Plant, and Equipment</p> <p>Exposure Drafts</p> <ul style="list-style-type: none"> Accounting for Revenue and Other Financing Sources Supplementary Stewardship Reporting

Figure V-1

Just as the traditional distinction between internal and external report users is less useful in the Army, some of the traditional ways of classifying financial reports are less relevant. The bottom line for the Army is not “profit.” The underlying objectives of Army financial reporting are stewardship, accountability, operating performance, budgetary integrity, and systems and control. As the Army moves forward in financial management reform, staying abreast of updates in authoritative guidance is essential.

Accounting for Property, Plant, and Equipment

One of the most sweeping departures from traditional financial reporting comes in the area of federal property, plant, and equipment (PP&E). The diversity among federal PP&E creates a need for meaningful categories with different accounting standards for each category. The FASAB, in its Statement of Federal Financial Accounting Standards (SFFAS) Number 6, identifies four categories of PP&E: (1) General PP&E, (2) Federal Mission PP&E, (3) Heritage Assets, and (4) Stewardship Land. The categories are described below.

General Property, Plant and Equipment: PP&E used in providing goods and services. General PP&E typically has one or more of the following characteristics: (1) it could be used for alternative purposes (e.g., by other federal programs, state or local government, or non-government entities), but is used to produce goods or services, or to support the mission of the entity, or (2) it is used in business-type activities, or (3) it is used by entities in activities whose costs can be compared to those of other entities performing similar activities (e.g., Army hospitals services in comparison to other hospitals). For activities operating as business-type activities, all PP&E shall be categorized as general PP&E, whether or not it meets the definition of any other PP&E category. Land and land rights acquired in connection with general PP&E shall be included in general PP&E.

Federal Mission PP&E: Includes certain items used to meet a federal mission in which the specific PP&E is an integral part of the output of the mission. PP&E should be considered federal mission PP&E if it possesses at least one of each of the two types of characteristics presented below. One type relates to the use of federal mission PP&E and the other type relates to its useful life.

Characteristics related to use: (1) has no expected non-governmental alternative uses; or (2) is held for use in the event of emergency, war or natural disaster; or (3) is specifically designed for use in a program for which there is no other program or entity (federal or non-federal) using similar PP&E with which to compare costs.

Characteristics related to the useful life: (1) has an indeterminate or unpredictable useful life due to the unusual manner in which it is used, improved, retired, modified, or maintained; or (2) is at very high risk of being destroyed during use or premature obsolescence. Federal mission PP&E specifically includes weapon systems (e.g., fighter/attack aircraft, submarines, and tracked combat vehicles) and space exploration equipment. It excludes land.

Heritage Assets: PP&E that are unique for one or more of the following reasons: (1) historical or natural significance; (2) cultural, educational or artistic importance; or (3) significant architectural characteristics.

Stewardship Land: Land and land rights owned by the federal government and not acquired for or in connection with other general PP&E.

The significance of the various PP&E categories rests in their recognition and reporting in the financial report. Only the general PP&E category will be reported in the balance sheet, at historical cost and subjected to depreciation. Federal mission PP&E, heritage assets, and stewardship land will be reported, at either latest acquisition or historical costs, in a supplemental stewardship report. Depreciation will not apply. The provisions of SFFAS #6 will become effective in FY 1998; however, Army is exploring the possibility of implementing the provisions in the FY 1996 general fund CFO report.

America's Army

Serving the Nation

Through Progressive Stewardship